GLOBAL TRENDS IN FOREIGN DIRECT INVESTMENT

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Abstract:

For the second year in a row, the global community has been affected by the pandemic crisis. The hopes for overcoming it have not yet been realized due to contradictory processes with different shapes. Against the background of this crisis, as well as the cyclical economic crisis triggered previously, a new type of global economic crisis is unfolding, which together with the other factors has affected all aspects of human activity, including economic and financial. One of the main forms of manifestation of this crisis is the maintenance during the last four years of the general trend of decreasing the volume of foreign direct investments. Important changes have also taken place in their structure. All this confirms the hypothesis of the sensitivity of foreign direct investments to the onset of economic crises, which determines a certain skepticism for the realization of the optimistic scenarios for the recovery of the situation.

Keywords: *foreign direct investment, pandemic crisis, decline*

JEL classification: *G01, F21*

Introduction

Foreign direct investment (FDI) is a form of capital investment in the territory of a country by non-resident investors.

They are a form of international investment and form an important segment of the international investment market. Likewise, they are an element of the process of economic and financial internationalization, being the foundation of economic and financial globalization. Some specialists also highlight them as part of investment globalization.

OECD experts expressed the following opinion: "Foreign direct investment is an integral part of an open and effective international economic system and a major catalyst to development. Yet, the benefits of FDI do not accrue automatically and evenly across countries, sectors and local communities. National policies and the international investment architecture matter for attracting FDI to a larger number of developing countries and for reaping the full benefits of FDI for development. The challenges primarily address host countries, which need to establish a transparent, broad and effective enabling policy environment for investment and to build the human and institutional capacities to implement them". (OECD, 2002)

The pandemic crisis has affected much of the global community's economic and financial activities, including foreign direct investment.

According Joseph E. Stiglitz, "Covid-19 is the largest shock to hit the global economy in living memory—certainly since the Great Depression. It is a complex shock. It affects demand and supply. It affects different sectors, different technologies, and different people differently. It has come on with the suddenness associated with crises, but with few of the warnings associated with an impending crisis." (Stiglitz, 2020)

In 2020, the volume of FDI collapsed under the pressure of multiple determinants. However, this impact was not uniform. The geographical distribution of the influence of the COVID-19 crisis was very diverse from one region to another, and manifested itself differently in countries around the world.

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The main influence was exercised in the first half of 2020. In the second half of 2020, cross-border M&A and international project financing transactions largely recovered. However, Greenfield investment continued its negative trend throughout 2020 and in the first quarter of 2021. (UNCTAD, 2021)

In more detail, the research results will be presented in this article.

Description of the Problem

The present research follows studies of the dysfunctions of financial globalization, which can generate problems of different nature, including financial crises. The global oscillations generate certain important imbalances, which have a propagated effect over time. In turn, IDFs are dependent on a number of factors. Following the examination of the FDI issue, the hypothesis of the sensitivity of foreign direct investments to the onset of economic and financial crises was put forward. This study is complicated by the overlapping effect of two global economic crises - the fundamental pro-cyclical crisis and pandemic crisis. The findings of study intend to increase the level of predictability of FDI dynamics.

Methodology and Data

In order to carry out the study, first, data on foreign direct investments of UNCTAD were examined and analyzed starting with the 1990s and until now. Then the publications of different experts in this field were researched. Following the accumulation of the necessary data, their synthesis was performed and related conclusions were formulated.

Results

To begin with, let us examine the dynamics of FDI over 31 years, which is shown in Figure 1.

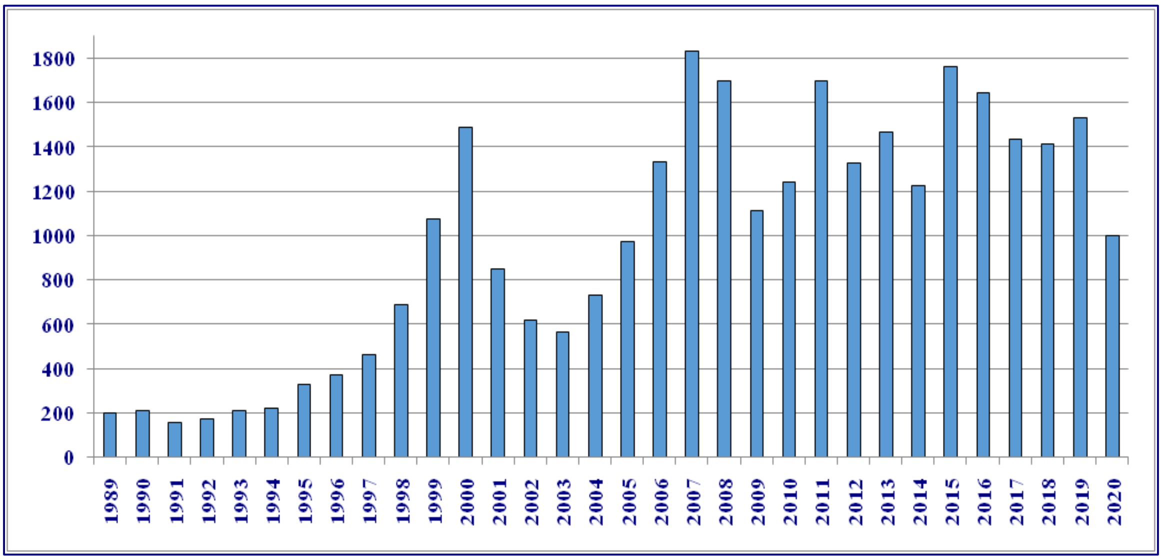

Figure 1: Dynamics of global FDI flows (billion USD)

Source: (Birca et al., 2020), (UNCTC, 1991), (UNCTAD, 2021)

The volume of FDI in 2020 amounted to 999 billion USD, decreasing compared to the previous year by USD 531 billion or 34.7%.

Thus, the UNCTAD forecasted for 2020 that the global volume of FDI will decrease by 42%, ie to fall to level of USD 858 billion, did not come true. (Global, n.d.)

But during the years 2016-2020 a downward trend was formed, which resulted in a general decrease compared to 2015 by USD 763 billion or 43.3%.

For the initial formation of the downward trend, in the opinion of some experts there were certain reasons (Birca, 2020):

•FDI loses its role as a means of circumventing customs barriers. With the substantial development of product supply possibilities in any part of the world, FDI is gradually ceasing to be used as a tool to occupy local markets by organizing the production of goods instead of distribution to consumers. Many transnational companies have given up their intentions to produce goods or provide services as part of domestic economic circuits in order to accept different outsourcing solutions.

•Take action in many countries to set barriers to FDI from offshore areas, especially from jurisdictions with a low level of transparency.

•More and more international investors prefer liquid investment objects due to maintaining a high level of financial (and other) instability at regional and global level. Moreover, FDI is related to investments in relatively low liquidity instruments.

Other experts (Fetiniuc et al., 2020), in turn, draw attention to the global cyclical economic crisis in the mentioned period, which manifested itself in the following:

- In 2015–2016, the Chinese stock market turbulence brought significant losses.

- In the years 2016-2018, there have been serious liquidity disruptions on the international financial market, which destabilizes some important ones. (Malin, 2018)

- During 2018, there was a significant decrease in some stock indices: Dow Jones - by 5.6%, S&P 500 - by 6.2%, Nasdaq - by 4%. And in December 2018, a real international stock market crisis broke out, which was manifested by the fall of the Dow Jones Index by 8.7%, S&P 500 - by 9%, NASDAQ - by 8%. (Isidore, 2018) In February-March 2020, the first signs of the low liquidity crisis COVID-19 began to appear in some segments of international financial market, which led to a global stock market crisis, which was directly manifested by the fall of certain stock indices.

- In mid-2018, the US-China trade war began and lasted more than a year.

- Substantial uncertainties for the economies of European states have been linked to the withdrawal of the United Kingdom from the European Union (Brexit). British and EU growth stagnated in 2019 until Brexit. The UK experienced a severe recession in 2019, which weakened the British economy in early 2020. Many companies left the UK to move to the EU, leading to trade losses and economic recession for both EU members, and for the United Kingdom.

- In March 2020, Saudi Arabia launched a price war with Russia, causing a 65% drop in oil prices. US oil prices fell 34%, crude oil prices fell 26%, and Brent oil fell 24%. (*2020…*, n.d.)

Therefore, the pandemic crisis was only a catalyst for the decline in global volume of FDI.

According Congressional Research Service, "The pandemic has disrupted lives across all countries and communities and negatively affected global economic growth in 2020 beyond anything experienced in nearly a century. Estimates indicate the virus reduced global economic growth in 2020 to an annualized rate of -3.4% to -7.6%, with a recovery of 4.2% to 5.6% projected for 2021. Global trade is estimated to have fallen by 5.3% in 2020, but is projected to grow by 8.0% in 2021". (Congressional Research Service, 2021)

The pandemic cataclysm also has certain propagated effects.

The pandemic crisis has contributed to the increase of Fiscal Deficits Relative to GDP to the level of 10.8% in 2020, which is to be reduced in 2021 and 2022, respectively, to 9.2% and 5.4%. (Congressional Research Service, 2021)

The desire of central authorities in different countries to mitigate the impact of the pandemic crisis and the strengthening of the economic enforcement during the post-crisis period through massive financial injects has contributed to the formation of inflationary processes. In particular, prices in raw materials and consumer demand have increased.

For example, monthly inflation in the euro area between January-July 2021 gradually increased from 0.9% to 2.2%. (*Euro*, n.d.) In the same period, US inflation increased from 1.4% to 5.4%. (*Monthly*, n.d.)

The analysis of FDI dynamics also denotes other cases of sensitivity of foreign direct investments to economic-financial shocks:

•The recession of the early 1990s led to a reduction in FDI by USD 53 billion or 25.1%;

•The bursting of the Dot-com Bubble in 2002 combined with economic and financial crises in a number of countries during 2001-2002 led to a decrease in the global volume of FDI of USD 288 billion or by 33.8%;

•The international economic and financial crisis of 2007-2009 caused the volume of FDI to decrease by USD 719 billion or by 39.2%.

It is important to change FDI's proportions between countries - developed, developing and transition. (Figures 2 and 3).

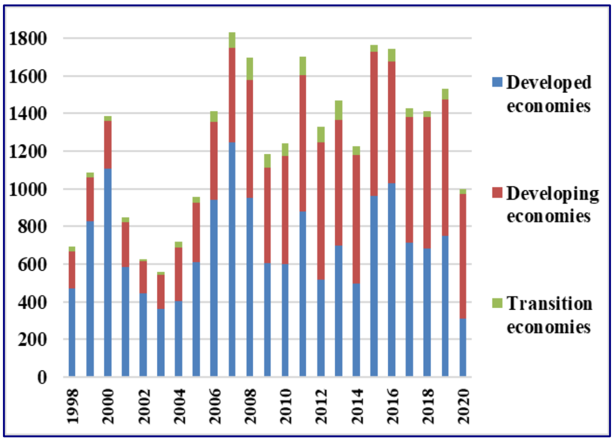

Figure 2: Global FDI flows divided by group of countries (billion USD)

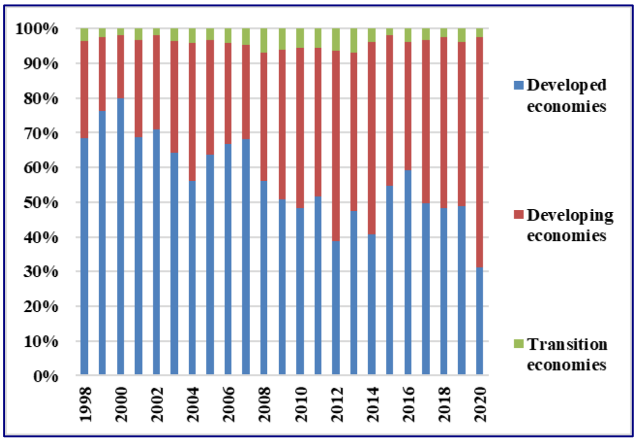

Figure 3: Dynamics of structural changes of global FDI flows divided by groups of countries (%)

Source: (Birca et al., 2020), (UNCTAD, 2004), (UNCTAD, 2021)

In 2020 developed industrial countries, attracted FDI in volume of USD 437 billion, decreasing compared to the previous year by 58.3%. At the same time, their share in the total volume of FDI also decreased - from 79.8% in 2000 to 31.2% in 2020.

FDI attracted by developing countries have been affected the least, accounting for USD 663 billion, with a decrease of USD 60 billion or 8.3%. In addition, their share in the total volume increased from 18.2% to 66.4% in 2020.

FDI of transition countries amounted to USD 24 billion with a reduction of USD 34 billion or 58.6%. And their weight changed insignificant, respectively, from 2.0% to 2.4%.

Presents interest the impact of the Pandemic Covid-19 crisis on the FDI geographic distribution (Figure 4).

The main share in the global volume of FDI is held by Asia - 53.6%. Foreign direct investment in this region amounted to USD 535 billion, increasing by USD 19 billion compared to 2019 or by 3.6%.

North America attracted FDI in 2020 in the amount of USD 180 billion (with a share of 18,0%), reducing compared to 2019 by USD 129 billion or 44.3%.

In Europe, the FDI reduction was a disastrous one of USD 290 billion or 168.6%, falling in 2020 to the level of USD 73 billion (with a share of 7,3%).

Latin America and the Caribbean attracted USD 88 billion in foreign direct investment in 2020 (with a share of 8.8%), with a decrease compared to 2019 of USD 72 billion or 49.0%.

Africa traditionally remains the region with the lowest level of FDI, which in 2020 amounted to USD 40 billion (with a share of 4%), down from the previous year by USD 7 billion or 15.2%.

The geographical distribution of FDI can also be presented in the light of the following groups of countries:

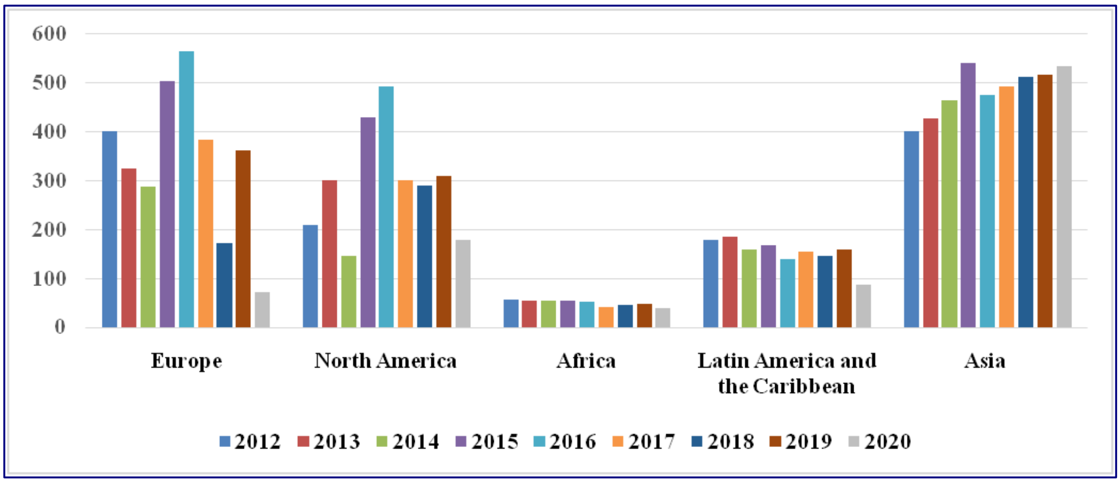

Figure 4: Global geographical distribution of FDI (billion USD)

Source: (Birca et al., 2020), (UNCTAD, 2021)

•G20 - in 2020 the volume of FDI amounted to USD 624 billion, decreasing compared to the previous year by 31.6%;

•RCEP (Regional Comprehensive Economic Partnership) - FDI was attracted in the amount of USD 344 billion, with a reduction of 15.1%;

•BRICS (Brazil, Russian Federation, India, China and South Africa) - USD 263 billion (-13.7%);

•USMCA (United States – Mexico – Canada Agreement) - USD 209 billion (-39.1%);

•CPTPP (Comprehensive and Progressive Agreement for Trans-Paci¬cPartnership) - USD 207 billion (-30.7%);

•AfCFTA (African Continental Free Trade Area) - USD 38 billion (-15.4%).

Also, the impact of the pandemic crisis on the attraction of FDI by some countries is remarkable (Figure 5).

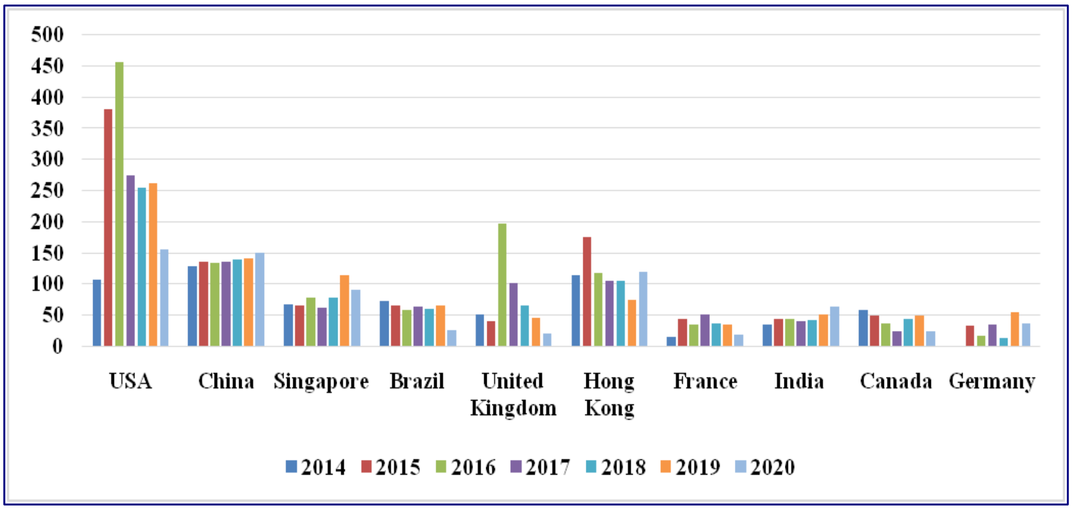

Figure 5: FDI distribution by main host countries (billion USD)

Source: (Birca et al., 2020), (UNCTAD, 2021)

China has an important share in the global volume of foreign direct investment (14.9%) and has managed to maintain the upward trend of FDI over the past 4 years. FDI in this country in 2020 amounted to USD 149 billion and increased by USD 8 billion (or 5.7%) compared to the previous year.

Foreign direct investment in Hong Kong in 2020 amounted to USD 119 billion (with a share of 11.9%), increasing by USD 45 billion (or 60.8%) compared to 2019.

The USA has the largest share in global FDI (15.6%), but the dynamics of their attraction is very unstable. In 2020, FDI was attracted in the amount of USD 156 billion, decreasing by USD 105 billion or by 40.2% compared to the previous year.

Singapore, too, is among the leaders in attracting FDI, with a volume of USD 91 billion in 2020 (with a share of 9.1%), with a reduction of USD 23 billion (or 20.1%) compared to 2019 .

In addition to those mentioned, changes in FDI types should be noted (Figure 6).

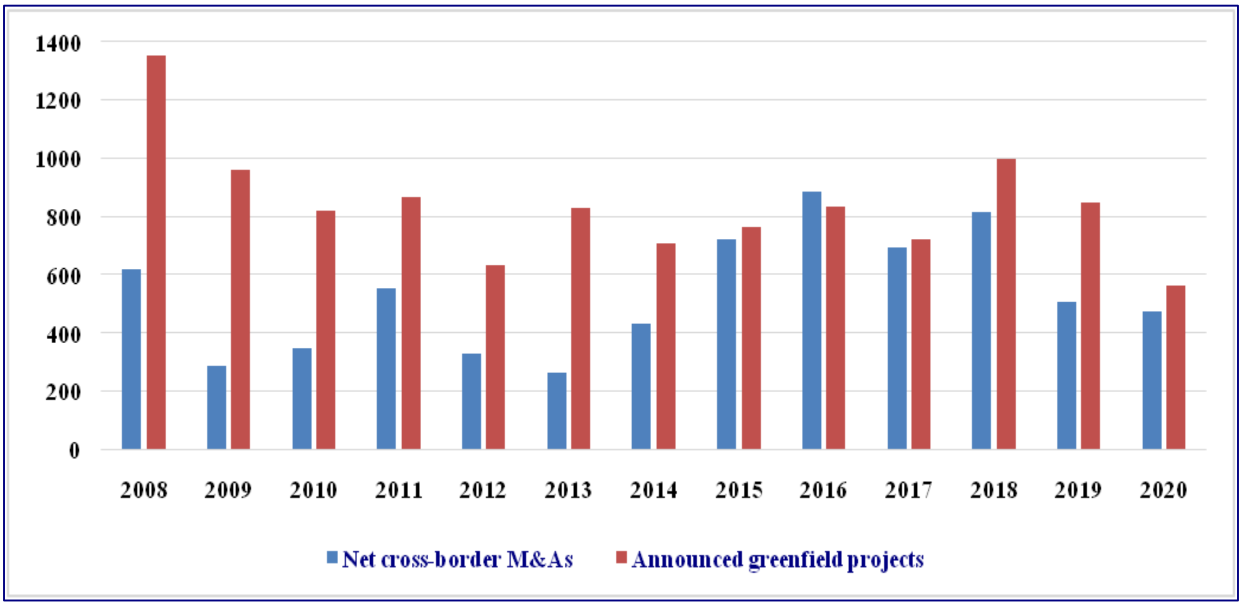

Figure 6: Dynamics of cross-border M&As and announced greenfield projects (billion USD)

Source: (Birca et al., 2020), (UNCTAD, 2021)

In 2020, the net value of mergers and acquisitions was USD 475 billion, down USD 32 billion (or 6.3%) from 20219. Of this volume, USD 379 billion is from industrially developed countries, USD 84 billion - from developing countries and 12 billion USD - from transition countries.

The total amount of announced Greenfield projects in 2020 amounted to USD 564 billion, decreasing compared to 2019 by USD 282 billion (or 33.3%). Of this volume, USD 175 billion belongs to industrially developed countries, USD 255 billion - to developing countries and USD 20 billion - to countries in transition.

The value of international project finance in 2020 was USD 366 billion, down USD 268 billion (or 42.3%) from 20219. Of this volume, USD 379 billion is from industrially developed countries, USD 170 billion - from developing countries and USD 21 billion - from transition countries.

After the analysis, it is natural to draw certain perspectives on the evolution of FDI globally in the post-crisis period.

According to many experts, the effects of the pandemic on SDI flows will be long-lasting. In the process of long-term recovery of global FDI flows, peak levels in 2016 are unlikely to be exceeded by 2028. (*The 2021*, n.d.)

In line with UNCTAD forecasts, global FDI flows are expected to increase in the range of 10-15%.

and in 2022 to reach the level of 2019 of USD 1.5 trillion. (UNCTAD, 2020)

The relatively modest pace of global FDI growth forecast for 2021 reflects the uncertainty surrounding the vaccination process, the emergence of new pandemic mutations and the slowdown in the resumption of activities in many economic sectors. However, if FDI tends to follow other macroeconomic indicators after the pandemic shock, a full recovery of FDI flows to pre-pandemic levels should be expected.

However, it is remarkable that FDI growth rates will be uneven in structural sections. Industrially developed countries will stimulate FDI growth both through important cross-border M&As and by promoting public investment. FDI inflows into Asia will maintain their growth rates as a region that has stood out as an attractive destination for FDI throughout the pandemic.

Author Basu Sharma affirms: "When countries slowly emerge from their lockdowns as the Covid-19 pandemic begins to recede, one crucial problem for governments everywhere will be to figure out ways to mitigate its negative effect on economic growth. And foreign direct investment (FDI) becomes an important factor to support economic recovery in the face of depleted internal resources". (Sharma, 2021)

Other experts are of the opinion that "this crisis may offer a window of opportunity for governments to re-examine their approaches to investment attraction and retention, with a view towards increasing the embeddedness of FDI within their local economies". (*Foreign*, n.d.)

At the same time, it is predictable that competition between countries will intensify in order to attract FDI. In this context, it should be noted that developing countries have significant budgetary constraints and can be largely limited to implementing policies based on investment facilitation measures for the simple reason that they do not have the necessary financial means to support private sector companies. (*Foreign*, n.d.)

During the pandemic, a significant number of FDI projects were postponed for the post-pandemic period, which will require a readjustment to new conditions. Some experts consider it likely to change of foreign investors' preferences and behavior. (*COVID*, n.d.)

By generalizing the opinions of the experts regarding the relaunch of the process of attracting FDI by the interested countries, the following recommendations can be formulated:

- It is necessary to develop and implement programs to support economic activity at the local level, which would be interesting to foreign investors.

- Because of the pandemic crisis, certain important transformations are taking place in the world economy, which must be taken into account in readjusting the landmarks of FDI attraction policies.

- It is necessary to review the role of free economic zones in all their forms in attracting FDI, based on the permanent changes in the world economy.

- A review of the possibilities for applying fiscal instruments to attract FDI is needed, as their impact is sensitive to quality of economic policy, objectives and tasks set by the State. It is also necessary to keep in mind that each instrument has its advantages and disadvantages in the process of tax regulation of investment activity.

Conclusions

Foreign investment is a part of financial globalization, being to some extent a factor in the economic development of host countries. However, their form, based on the specifics of the performance and the behavior of investors, determines this impact. The pandemic crisis has contributed to the significant contraction of the global volume of FDI, which is in line with the dominant trend of reducing the volume of foreign direct investment worldwide. The collapse of the global volume of FDI, in essence, is the result of the synergistic effect of the general downward trend in FDI and replacement with other forms of international economic and financial cooperation, the previous development of the cyclical global economic crisis and the onset of the pandemic crisis. FDI's sensitivity to economic and financial crises largely depends on the level of damage to major countries, which attract foreign direct investment. At present, the intensification of global competition between countries for attracting foreign direct investment as a factor of economic recovery becomes predictable. In this sense, it is possible to use the entire arsenal of economic and financial levers to stimulate the inflow of FDI on the territory of the interested countries. But for this a very careful readjustment of the investment policies of the respective states is necessary.

Future Directions

The results of the study will be integrated into general research on global financial imbalances. Also, once the pandemic has not ceased to vaccinate the global population, it is time to continue observations on the evolution of the global pandemic crisis. Therefore, when the pandemic crisis ends, it will be necessary to return to the analysis performed in a renewed regime.

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